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Promoting Transparent Pricing in the Microfinance Industry

African Microfinance Pricing Transparency Leadership Forum

Forum Report Summary

October 5-7, 2011 | Nairobi, Kenya

AGENCE FRANÇAISE DE DÉVELOPPEMENT

LE GOUVERNEMENT DU GRAND-DUCHÉ DE LUXEMBOURG
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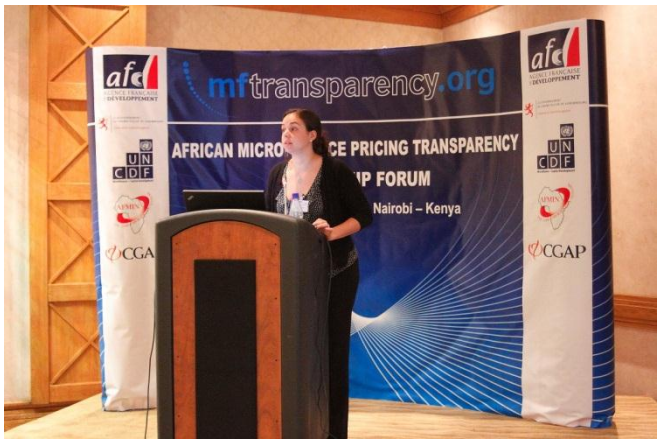

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Event Summary

In October 2011, MF*Transparency* hosted the **African Microfinance Pricing Transparency Leadership Forum** in Nairobi, Kenya. This was the first event of its kind, bringing together policymakers, regulators, networks and a host of industry experts to discuss issues related to pricing transparency in African microfinance markets. More than 120 people comprised this carefully selected participant group, representing 24 different African countries. MF*Transparency* compiled country teams that would be able to achieve the two main objectives:

- Represent the experience of their country in developing a regulatory framework for pricing disclosure in the microfinance market, so that other countries could learn from it; and,
- Synthesize the learnings of the forum into an actionable strategy for facilitating pricing disclosure in their home country microfinance market

Toward this end, it was important to include not only the regulator perspective but also that of the industry (through network representatives) and clients (through consumer protection agencies) as well, with industry experts on hand to provide technical backing to discussions and planning sessions.

These teams underwent a full three-day agenda with vigor. On the first day MF*Transparency* Chief Executive Officer (CEO) Chuck Waterfield and Chief Operating Officer (COO) Alexandra Fiorillo guided the group through a day-long training series designed to reinforce the principles underlying pricing transparency, discuss approaches to calculating transparent prices and share examples of effective policy that MF*Transparency* has observed in our work around the world. Day 2 started off with a riveting inaugural speech by Professor Njuguna Ndung'u, Governor of the Central Bank of Kenya. The day proceeded with thematic workshops and round table discussions centered around the topics of pricing calculation, standards for reporting and spilling over into a third day with a session on financial education. On the final day of the event participants also had the opportunity to hold strategic planning meetings, within their own country teams, directly with other country teams and in consultation with industry policy experts and technical assistance providers.

Not only was this the first event to bring together this unique combination of individuals, it also took a decidedly different approach from many industry conferences. While the trainings of Day 1 of the event served to ground participant discussions in a common level of technical understanding, the sessions that followed all heavily emphasized attendee participation and discussion. While MF*Transparency* is privileged enough to speak to policymakers and regulators in countries across Africa, we observed that these individuals do not often have an opportunity to speak with each other. In fact, some country teams commented that they do not even have so much time to see colleagues from their own country working in other institutions as they did at the Forum in Nairobi. The majority of time at this event was therefore spent in roundtable discussions, which proved to be quite lively and even animated on certain issues! Some topics, such as ideas for pricing disclosure formulas, stirred up questions and debates, while others, such as requirements for financial institutions to report on pricing, allowed some participants to present their particular approach and others to share their challenges and concerns and seek advice from their counterparts in other countries.

Perhaps the most important sessions of the event were those that led participants to consider the concrete next steps in their own process for building transparent markets. By Day 3 of the event, participants were fueled with

examples and ideas to discuss, knew which countries they were most keen to learn from and aware of which industry experts may be able to offer them the technical support they need. The agenda therefore allotted valuable time for developing action plans, which were afterwards shared among the group as a whole. This Forum was a beginning, getting a process started that each country team will fulfill in their own market in their own unique way.

This short event summary document is meant to provide a high level overview of the outcomes from the event. If you are interested in a more in-depth presentation of the **African Microfinance Pricing Transparency Leadership Forum**, please read the longer Forum Report, also available on the MicroFinance Transparency website.

In addition, we have prepared four short, content-specific documents meant to be used as resources for practitioners, regulators and other stakeholders. The resources we developed highlight the most salient discussions and themes from the Forum. They can also be found on our website and cover the following topics:

- African Microfinance Pricing Transparency Leadership Forum Discussion Insights: Challenges and Solutions
- The Debate about Official Pricing Disclosure Formulas
- Financial Education: Heard at the Forum
- African Microfinance Pricing Transparency Leadership Forum Discussion Insights: Stakeholder Roles & Responsibilities

Though the sessions of the Forum were divided along three main themes, pricing calculation, standards for reporting and client financial education, throughout the course of the discussions participants identified the relationships between them. New official pricing calculation formulas as well as standards for reporting increase the volume of information available and change the format of pricing information that industry players are used to seeing. This in turn is likely to raise questions among clients thereby increasing the need for financial education. Being able to address these questions in a meaningful way is vital, as MFIs may fear losing clients if clients lose **confidence** in them over a lack of clarity around pricing. This dynamic may naturally incentivize MFIs to make more efforts to educate clients, increasing the positive outcomes of pricing transparency.

Finally, the most repeated theme of the event was the need for capacity building at all levels of the market; this includes MFIs, clients, the media and even policymakers and regulators themselves. Questions of how to build capacity, whose responsibility it is, what skills are essential and who should fund the needed training processes remain, but with a general consensus on the importance of this step the practical solutions are likely to evolve over time.

The Debate about Official Pricing Disclosure Formulas

One of the three main themes of the African Pricing Transparency Leadership Forum was Pricing Calculation. Training sessions given by MF*Transparency*, as well as a plenary discussion moderated by Moses Ochieng of

CGAP/DFID and led by Ghépié Anin of BCEAO and Gladys Chongo Mposha of Bank of Zambia, launched an ongoing debate among participants about what an official pricing disclosure formula should include. This article provides insights from this debate, highlighting the most essential issues to be addressed to establish widespread agreement on this critical element of pricing disclosure policy.

Background

The policy frameworks governing many microfinance markets around the world sometimes include an official formula for calculating and disclosing the prices of microloans. Typically this official formula specified by legislation implemented by the regulatory agency tasked with governing the microfinance market, and is adopted for multiple reasons including:

- Client protection
- Improved reporting standards for microfinance institutions
- Overall increased transparency in the disclosure of the prices of microloans

The official legislation will specify:

- Formula for calculating the official price and how to apply the formula
- What types of institutions and credit products the official formula applies to
- How the official price must be communicated (e.g. via loan documentation, reports to the regulator, displays on the walls of branch offices) and to whom (egg. borrowers and/or the regulatory authority)

As the goal of this official formula is to institute a standard format for pricing disclosure, typically the formula incorporates standard loan terms and repayment frequencies and takes into account some or all charges in addition to interest. Beyond the theoretical issues raised by the discussion of what should be included in an official pricing formula, participants in the Forum also shared their experiences in facing many practical issues in establishing and enforcing pricing disclosure.

Self-Regulation vs External Regulation

Many participants in the Forum expressed the opinion that some aspects of pricing disclosure should be enforced through self-regulation and others through external, official regulation. One important benefit to at least a partial self-regulatory approach is that in many microfinance markets a significant portion of the market is not under the purview of the regulatory authority. If a regulator were to require only regulated institutions to adhere to an official pricing formula, allowing unregulated institutions to continue to use non-transparent practices, this could create a significant market distortion. In addition, it could actually make the environment for clients worse, creating more variation in pricing and more confusion about which products represent the best option.

Standardized Loan Documentation

Many participants at the Forum raised the point that an official pricing disclosure formula is only as powerful as the extent to which the standard rates are disclosed. When discussing what pricing components should be included in an official pricing formula, it may be equally important to define which components are disclosed through loan documentation given to borrowers. If an official pricing disclosure formula requires institutions to

report an APR or EIR to the regulator, shouldn't they also be required to share it with the borrowers? If knowing the total cost of credit is not enough for policymakers and industry professionals, why should it be enough for borrowers?

In addition to the content of pricing information disclosed on loan documentation, the manner of disclosure was discussed as well. Many participants advocated the requirement of a standard template to prevent institutions from burying important information deep into long documents or to present it in confusing ways. Templates also make it much easier for clients to "shop around" and make comparisons between products.

Limitations of Technical Capacity

Concerns about the technical abilities of microfinance institutions to absorb new requirements are always present but particularly acute when it comes to pricing calculations, a topic that even top experts struggle with. Much of the discussion about official pricing formulas centered on the challenge of preparing institutions to adhere to any new requirements. All agreed that training and capacity building would be necessary in order to make the use of any official formula feasible. Other ideas for supporting the process included the provision of software and tools for MFIs to use to convert their current calculations to a new official formula.

In addition, to backstop the implementation of new policy it is important to educate the clients themselves. An informed public, who is aware of their rights and the standards of service they are entitled to, can be a valuable component to the success of a new policy. The question of educating clients, however, raised even more questions and difficulties than that of educating institutions.

Making the Switch from Flat to Declining

Adjacent to the discussion of what type of formula might constitute an ideal official pricing disclosure formula, participants discussed the question of the flat vs declining balance methods of calculating interest extensively[1]. Most agreed that any official formula in place should use the declining balance method, and possibly even forbid the use of the flat method, but they also expressed concerns about the process of actually implementing such a requirement. How can we get an entire industry to shift from using predominantly flat to all declining balance rates? Is there a way to ease into this? Perhaps of most concern, once we require institutions to switch to the declining balance rate, what if we discover that prices are much higher than we thought? What kind of backlash might result from politicians, media, funders and the general public?

These are questions that MF*Transparency* is highly focused on, as we are strong advocates for the banning of flat interest rates. Our entire data collection methodology centers on the fact that we publish prices for the market as a whole at the same time. This way if the true prices are a surprise to the industry, at least they undergo the process of becoming transparent together rather than singling out a few institutions. In addition, we provide helpful resources targeted specifically at the issue of flat interest, including an article explaining this dynamic in microfinance, a model repayment schedule showing how the declining balance rate can be

[1] Through the flat balance method of calculating interest the borrower pays interest on the initial loan amount throughout the loan period. Through the declining balance method, the borrower only pays interest on the loan amount they have in their possession as they repay principle over the course of the loan term. The declining balance method is widely considered to be fairer and more transparent because the borrower only pays interest on the money they have at their disposal.

communicated to borrowers clearly and simply and a price calculator that enables policymakers and regulators as well as institutions to translate flat prices into declining to see how they will appear once converted.

Strategy for Successful Implementation

Once an official formula has been selected, participants discussed many challenges to its implementation. The following are three of the core themes discussed at the event, which should form the foundation of the strategy for developing and implementing an official price formula:

Training and Capacity Building

Even the best decision regarding the implementation of an official formula can only be as good as the framework in place for applying it. Training, capacity building, technical assistance and education are needed at all levels. Policymakers and regulators must be informed about the reality of pricing in the market in order to make good policy decisions, networks must be informed about new policies in order to support institutions in implementing them and the institutions themselves must be capable of calculating a new pricing formula in order to effectively adhere to disclosure requirements. In addition, educating borrowers and the media will help to ensure that the intention of an official formula comes to bear, facilitating widespread understanding of pricing. Regulators and policymakers can provide tools and software to make the process of adopting new formulas simpler.

Coordination between Stakeholder Groups

Particularly as it relates to the previous point, coordination between different stakeholder groups is essential for the implementation of all types of new policy requirements. Understanding of the different perspectives of institution, regulators and borrowers is essential for developing policies that benefit all. In addition, each group has a role to play in making this a practical success. For example, technical assistance providers can train institutions on how to calculate prices using a new official formula. Donors can consider funding financial education programs for clients and investors can support regulators in enforcement by requiring their partners to use the official formula as well as report their rates directly. Networks can act as a liaison between these groups to facilitate discussion and ensure that the perspective of each is understood.

Pricing from the Client Perspective

While not all participants in the forum necessarily expressed this view, it is MF*Transparency*'s position that a truly transparent price takes into account all costs paid by the borrower in order to access credit, regardless of whether the institution benefits from them or not. We believe that official pricing formulas should also take this perspective. Institutions should be required to disclose all costs a borrower is likely to face when accessing a microloan. In addition, institutions should be required to disclose this information in multiple formats so that in addition to the official rate borrowers also know their installment amounts, repayment frequency, any late payment penalties, etc. We believe that through putting the client perspective first in terms of pricing disclosure, all stakeholders in the market benefit.

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Financial Education: Heard at the Forum

Client financial education was one of three core themes discussed at the African Microfinance Pricing Transparency Leadership Forum. A roundtable discussion between Daniel Tallam of the Central Bank of Kenya, Lanjes Sinoya of the Reserve Bank of Malawi and Kobina Amoah of the Ministry of Finance and Economic Planning of Ghana, moderated by Bilha Maina of Financial Sector Deepening Kenya, provided substantive material that sparked the lively roundtable discussions that followed.

Everyone at the Forum agreed that client financial education is critical to facilitating transparency, building strong markets and ensuring that microfinance fulfills its social mission. Financial education arose in discussions of the other two core themes, indicating how fundamental this consideration is to all other industry building efforts. As it is the responsibility of regulators and policymakers to help protect clients, financial education seemed to be of equal concern to participants as the role of pricing disclosure in institution financial sustainability.

In particular, participants agreed that educating clients about pricing is essential to any successful effort toward transparent pricing. Not only should clients be able to understand prices and how to make decisions between different products, they should also be educated on how to determine when to borrow and when not to borrow as well as how much. Participants felt it was important to educate clients on pricing as it pertains to the range of products offered by microfinance institutions, not just credit.

Financial education allows borrowers to make better financial decisions, but it can also help make borrowers more aware of their rights and the regulations protecting them. New client protection or pricing disclosure policy is more likely to be effective if the clients it is designed to benefit are aware and can demand the rights and information they are due.

In addition, new pricing disclosure policy means more pricing information available to clients and may also mean confusion among borrowers who do not understand the information they now have access to. If a new policy requires institutions to publish the Effective Interest Rate (EIR) on all repayment schedules but borrowers do not know what EIR is, the policy is minimally effective. If clients raise questions that institutions are not equipped to answer, then those institutions risk losing the trust of their clients. In this sense, pricing disclosure policy and client financial education are mutually dependent approaches for strengthening the microfinance sector.

Regardless of the mechanism chosen for delivering financial education programs to clients, participants agreed that extensive research and preparation is necessary, including initial needs assessments, pilot phases of new projects and ongoing evaluations of client satisfaction and overall impact of any given approach. In particular, regulators and policymakers in attendance felt that they required baseline research to better understand financial education levels before moving forward with designing programs. Delegates from Ethiopia, Malawi, South Africa, Tanzania and Zambia all shared their experiences with conducting such research, prompting the suggestion that regional collaboration on the issue of financial education could potentially be a highly effective approach.

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The Way Forward

Many participants commented that this Forum was one of the liveliest industry events they have witnessed. Observing the discussions was quite exciting as all attendees actively participated, new ideas circulated in a constant flow and knowledgeable industry leaders discussed some of the most contested topics in microfinance. A few core ideas defined this event:

- **Exchange of experience is essential to effective practice.** As important as it is to become an expert in whatever specific geographic or topical area of the industry that you inhabit, it is equally vital to learn from peers in other areas so that lessons can be applied in different country contexts or so that the same mistakes are not made elsewhere.
- **Innovation is inherent to building transparent markets.** Policymakers in Africa understand that to effectively regulate for transparency they need to be innovative and go beyond established practices to identify new approaches that will increase transparency while not making it too difficult or expensive to serve clients currently unserved or underserved.
- **All members of the ecosystem are engaged.** Many partnerships are forming between different regulatory bodies as well as networks, consumer protection agencies and other industry support organizations. The best policy is only as effective as its implementation, and African microfinance industry stakeholders are working closely to put in place policies that are practical and benefit the industry as a whole.
- **Africa is setting an example for the rest of the industry.** The regulators of African microfinance markets are committed to building strong, transparent microfinance markets. More mature markets are taking a bold look at how to restructure policies to incentivize pricing disclosure, and more nascent markets are incorporating pricing transparency into the core of their policy frameworks as they are developed.

In order to maximize the ongoing potential for the microfinance industry to learn from this important event, MF*Transparency* published all the presentations and related resources from the event on the website. This report is intended to be used as an educational resource as well, drawing out themes that a range of industry stakeholders can use to shape discussions and strategies for facilitating pricing transparency through innovative policy measures. Many participants are already beginning to implement their action plans.

Thank you to our Steering Committee – comprised of representatives of Agence Française de Développement (AFD), UNCDF, CGAP and the African Microfinance Network (AFMIN) – the funders of the event (AFD, Luxembourg Cooperation and UNCDF), our speakers, moderators and discussion facilitators and all the participants for their contributions to making the Forum a truly valuable platform for discussion and planning.